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No. 04-1704

In the Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION,

Petitioner,

v.

CHARLOTTE CUNO, ET AL.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITIONER'S REPLY BRIEF

CHARLES A. ROTHFELD
Counsel of Record
ERIKA Z. JONES
KRISTINA S. BENNARD
Mayer, Brown, Rowe & Maw LLP
1909 K Street, N.W.
Washington, DC 20006
(202) 263-3000

Counsel for Petitioner DaimlerChrysler Corporation

CONTENTS

Page

TABLE OF AUTHORITIES ii

1. The Nationwide Importance Of This Case Warrants Review 1

2. There Is Great Uncertainty About The Application Of Commerce Clause Principles To State Tax Incentives 3

3. The Sixth Circuit's Decision Conflicts With The Michigan Supreme Court's Holding In *Caterpillar* 4

4. The Holding Below Departs From Commerce Clause Principles 5

CONCLUSION 7

TABLE OF AUTHORITIES

Page(s)

Cases:

Amerada Hess Corp. v. *Director, Division of Taxation*, 490 U.S. 66 (1989) 4

Caterpillar, Inc. v. *Department of Treasury*, 488 N.W.2d 182 (Mich. 1992) 4, 5

Goldberg v. *Sweet*, 488 U.S. 252 (1989) 6

West Lynn Creamery, Inc. v. *Healy*, 512 U.S. 186 (1994) 6

Westinghouse Elec. Corp. v. *Tully*, 466 U.S. 388 (1984) 4, 7

Wilkins v. *Cuno*, No. 04-1724 ..... 1, 2, 3, 7

Miscellaneous:

151 Cong. Rec. S5444 (daily ed. May 18, 2005) 1, 2, 3

Enrich, *Saving the States From Themselves: Commerce Clause Restraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377 (1996) 3, 6

Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447 (1997) 2

Hellerstein & Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789 (1996) 3

1. The Nationwide Importance Of This Case Warrants Review

The parties are in agreement on the central issue now before the Court in this case: all of them urge the Court to grant the petition for certiorari. Respondents acknowledge that "the issues raised by this case are of broad national importance, because they will apply to a range of comparable business tax incentives offered by many states." Resp. Br. 5. As we showed in the petition (and as respondents also recognize (see *id.* at 7-8)), the Sixth Circuit's decision is greatly impeding the use of business development incentives in all of those states. By doing so, the holding below *already* is affecting job-creation efforts in innumerable jurisdictions, interfering with the investment decisions of businesses and the financial plans of taxing officials across the Nation, and disturbing the long-settled expectations of taxpayers.[1] These unfortunate effects are highlighted by the extraordinary outpouring of *amicus* support for DaimlerChrysler's petition and the companion petition filed by the State of Ohio in *Wilkins* v. *Cuno*, No. 04-1724: *amici* urging the grant of certiorari include 27 states and the District of Columbia, the Nation's leading organizations of state and local officials, the broadest range of business interests, and organized labor.

Respondents are incorrect, moreover, when they seek to downplay the impact that tax incentives actually have on in-

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[1] As noted by *amici* States of Florida, *et al.*, the uncertainty created by the decision below as to the constitutionality of tax incentives even outside the Sixth Circuit means that corporations nationwide are "disinclined to rely on the incentives currently offered by the States." Br. of Florida, *et al.*, at 4. See also 151 Cong. Rec. S5444 (daily ed. May 18, 2005) (statement of Sen. Voinovich) ("States and businesses have been reluctant to go forward with new projects that depend on the availability of tax incentives out of concern that the *Cuno* decision may be used to invalidate those incentives.").

vestment decisions. See Resp. Br. 7. Respondents' assertion that incentives rarely influence such decisions is belied by the real-world actions of businesses and government officials: it is difficult to believe that state and local governments would forgo very substantial tax revenues (see *id.* at 6) unless they were getting something for the money. In fact, an assertion like the one advanced by respondents "seems odd. We typically think of competition as an effective mechanism for allocating scarce social resources to the party that values them most highly, and there initially seems little reason to believe that governmental bids vary from this principle." Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 448 (1997). The point is confirmed by the experience of *amici* like Nissan North America, Inc., Ford Motor Company, and General Motors Corporation, which represent that tax incentives have a significant impact on investment decisions – and that such incentives are especially important in giving state and local governments the wherewithal to compete with foreign nations for capital investment. See Br. of Nissan North America, Inc., at 8-12; Br. of Ford Motor Co. and General Motors Corporation at 5.[2]

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[2] See also Br. of International Union, United Automobile, Aerospace & Agricultural Implement Workers of America, UAW, at 3-5 (noting that tax incentives are essential for certain states and regions to compete for investment); 51 Cong. Rec. S5444 (daily ed. May 18, 2005) (statement of Sen. Voinovich) ("As a former Governor who had to compete against Japan, Canada, China and Europe for new business projects, I know just how important a role tax incentives can play in attracting new businesses. I can assure you that our competitors are certainly not going to stop using tax incentives.").

2. *There Is Great Uncertainty About The Application Of Commerce Clause Principles To State Tax Incentives*

The great practical importance of this case in itself makes review imperative. But it also is appropriate to note that respondents are wrong in contending that there is nothing "novel[]" in the Sixth Circuit's decision and that the holding below "follows straightforwardly from a long line of this Court's decisions." Resp. Br. 2. As we observed in the petition, commentators – including those whose views are endorsed by respondents (see *id.* at 3) – have described the "palpable tension in the Supreme Court's decisions" in this area (Hellerstein & Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 791 (1996)) and have noted that "the Court has not had occasion to address a challenge grounded in the claim that a state tax provision's primary purpose or effect is to attract business to locate or expand in the state." Enrich, *Saving the States From Themselves: Commerce Clause Restraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 381 (1996). Before the Sixth Circuit, respondents themselves candidly recognized that their claim rests on a "novel legal theory." No. 01-3960, *Cuno* v. *DaimlerChrysler Corp.* (6th Cir.), Pl. Br. viii.

Indeed, the uncertainty in this area of the law is manifest on the face of the Sixth Circuit's decision. The court of appeals acknowledged that "[t]he United States Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes." Pet. App. 5a. In nevertheless striking down Ohio's ITC, the Sixth Circuit refused to draw a distinction "between laws that benefit in-state activity and laws that burden out-of-state activity" because, "economically speaking, the effect of a tax benefit or burden is the same." *Id.* at 9a, 10a. Yet in the very next paragraph of its

opinion, the court *did* draw just such a distinction between "the investment tax credit [and] a direct subsidy," even though a subsidy (which plainly would be constitutional) "would no doubt have the same economic effect" as the tax credit. *Id.* at 10a. This inconsistency in the Sixth Circuit's approach – sometimes attaching dispositive significance to "formal distinctions that lack economic substance" (*Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 405 (1984)) and other times ignoring them – encapsulates the existing confusion in the law of the Commerce Clause as it relates to economic development efforts.

3. The Sixth Circuit's Decision Conflicts With The Michigan Supreme Court's Holding In Caterpillar

That confusion also is apparent in the significant tension between the Sixth Circuit's holding and the decision of the Michigan Supreme Court in *Caterpillar, Inc.* v. *Department of Treasury*, 488 N.W.2d 182 (Mich. 1992). As we showed in the petition (at 11-12), the Michigan court upheld that State's capital acquisition deduction (the "CAD") for the cost of acquiring real property located in Michigan, although no deduction was available for real property acquired in other states. Respondents attempt to distinguish *Caterpillar* from this case on the ground that *Caterpillar* involved a value-added tax that was based on the taxpayer's total Michigan business activity, rather than a corporate income tax. Because the tax base for Michigan's levy "was designed to include only the share of capital acquisitions attributable to in-state activity," respondents assert "that a deduction designed to be similarly restricted to capital acquisitions attributable to Michigan does not discriminate." Resp. Br. 17. But this is a distinction without much of a difference. State taxes based on corporate income, like the Ohio franchise tax at issue in this case, *also* are designed to capture only income that is properly attributable to activities in the taxing state; that is why states apply apportionment formulas to determine what

percentage of taxpayer income is subject to local tax. See, *e.g.*, *Amerada Hess Corp.* v. *Director, Division of Taxation*, 490 U.S. 66, 73-75 (1989). Michigan used just such a formula in calculating its value-added tax. See *Caterpillar*, 488 N.W.2d at 185-186.

In fact, Michigan did allow deductions from its tax for some expenses incurred outside the state, so long as those expenses were "related to Michigan business activity." *Caterpillar*, 488 N.W.2d at 186. Respondents therefore are wrong if they mean to suggest that the theory of the value-added tax permitted deductions only for expenses physically incurred in Michigan; Michigan's CAD actually offered an apportioned deduction measured by the value of tangible *personal* property acquired by the taxpayer out-of-state. See Pet. 11-12 n.7. Yet, to encourage in-state investment in *real* property, the CAD provided a deduction for the cost of acquiring such property only if it were located in Michigan. See Pet. 11. In doing so, Michigan offered a tax benefit for in-state business investment, while denying an equivalent benefit for equivalent investment made out-of-state – just as Ohio does here. The analysis used by the Michigan Supreme Court in upholding this regime cannot be reconciled with the Sixth Circuit's rationale for invalidating Ohio's similar tax incentive.

4. The Holding Below Departs From Commerce Clause Principles

Although detailed discussion of the merits of the case is premature at this point, it should be noted that respondents' defense of the Sixth Circuit's analysis is premised on a misunderstanding of the arguments presented in the petition. We do not contend, as respondents would have it, that the Commerce Clause invalidates only state laws that fall within particular narrow pigeonholes. See Resp. Br. 10-12. To the contrary, our disagreement with the Sixth Circuit stems from that court's use of a wooden, formulaic approach that is di-

vorced from the Commerce Clause's underlying concern with state protectionism and economic Balkanization. Had the court of appeals engaged in the "sensitive, case-by-case analysis of [the tax's] purposes and effects" that is mandated by this Court's decisions (*West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186, 201 (1994)), it would have seen that something has gone badly awry when *in-state* taxpayers successfully invoke the Commerce Clause to prevent tax cuts for *out-of-state* businesses that are seeking to expand their *interstate* operations. It is respondents' avowed goal, after all, to "save the states from themselves" by allowing domestic taxpayers to use the Commerce Clause against their own states when state officials offer tax incentives to lure business across state lines. Protecting state residents from their own state legislatures in this way may or may not advance a sensible policy goal – but it surely constitutes a radical departure from the principles that underlie the Commerce Clause.

In this regard, it is revealing that respondents nowhere address the "practical or economic effect" (*Goldberg* v. *Sweet*, 488 U.S. 252, 262 (1989)) of Ohio's ITC. As we showed in the petition (at 24-26), Ohio's incentive program offers a one-time benefit to taxpayers as a reward for engaging in specified economic activity; the ITC plainly was not intended to (and does not in fact) offer a systematic advantage to domestic businesses over out-of-state competitors. This sort of provision – designed "to invite, even entice, the outsiders in" (Enrich, *supra*, 110 HARV. L. REV. at 412) – is identical in its economic effect to a one-time subsidy, a type of business incentive that unquestionably is constitutional. See Pet. 25. Yet respondents do not offer any Commerce Clause policy that is advanced by invalidating such a provision, whether it is cast in formal terms as a subsidy or as a tax incentive.

We agree with respondents that no decision of this Court has upheld a provision just like Ohio's ITC. But as we showed in the petition (at 19-26), it is equally true that the

Court also has never invalidated such a provision.[3] Because a substantial majority of the states offer tax incentives that do not differ from the ITC in any material respect – and because the Sixth Circuit's decision has destroyed the certainty that is necessary for such incentives to operate – this Court's guidance is urgently needed.

CONCLUSION

For the foregoing reasons and those stated in the petition, the Court should grant the petition for a writ of certiorari in this case and in *Wilkins* v. *Cuno*, No. 04-1724.

Respectfully submitted.

CHARLES A. ROTHFELD
Counsel of Record
ERIKA Z. JONES
KRISTINA S. BENNARD
Mayer, Brown, Rowe & Maw LLP
1909 K Street, N.W.
Washington, DC 20006
(202) 263-3000

Counsel for Petitioner
DaimlerChrysler Corporation

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[3] Respondents suggest that *Westinghouse Elec. Corp.* is such a case. Resp. Br. 13. As we explained in the petition (at 20-21), however, that case was decisively different from this one because the New York provision there at issue not only rewarded in-state business operations, but also affirmatively penalized any increase in out-of-state activity. Respondents agreed with us on this point before the district court, acknowledging that "the presence of such penalties distinguishes the credit involved in *Westinghouse Electric* from the credit challenged here." R. 55, Pl. Commerce Clause DC Mem. 22-23, CA App. 372-373.